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Puerto Rico's Only Way Out Of Its Debt Mess Is Growth--Good Luck With That



GUEST POST WRITTEN BY
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[Anne O. Krueger and colleagues' report on Puerto Rico's finances](#) has confirmed what many locals had long internalized: its government will very soon face the choice of paying public employees, retirees or bondholders mostly residing in the U.S. [A pile of \\$73 billion in junk-rated debt](#) and almost completely unfunded pension liabilities had already attracted less able analysis from nervous bondholders, the U.S. government, editorials boards and just about everybody else in 140 words or less.



Puerto Rican Governor Alejandro Garcia Padilla said that the people will have to sacrifice and share in the responsibilities for pulling the island out of debt. (Photo by Joe Raedle/Getty Images)



On the fiscal front, the popular advice was to raise taxes. Governments obliged with an annual plea to the people for “one last tax increase” that would make all troubles disappear. But the economy would then contract, tax receipts declined, and the cycle would start once more. In less than a decade, about a quarter of all jobs have disappeared.

Job creation is the end result of economic growth, not the means to it

An economic death spiral of recession and taxes will not be how debts are repaid, in full or partially, [as the latter option has just been suggested by the island's governor](#). The only solution is economic growth, but it will not come through a focus on tourism, the knowledge economy, entertainment or any one sector. The unfortunate mistake that government officials and well-intentioned observers make is failing to recognize that job creation is not the means but rather the end result of economic growth.

In an international context, the historical drivers of development have been education, labor force growth, its increased utilization—such as through rising female labor force participation—and most importantly, technological change. It is the matching of resources through entrepreneurship that finds its way to opportunities. Krueger and colleagues are correct in pinning Puerto Rico's fiscal woes to structural impediments to growth, but the chances of a way forward are not good.

Puerto Rico's two major problems

Foremost, providing quality education is not our government's strongest suit. Even families at the poverty line are three times as likely as American ones to send their kids to private school. At higher income levels, avoidance of the public system can reach 80%. Labor force utilization is dismal—particularly among the low skilled. Over two-thirds of Puerto Ricans who did not complete high school are neither working nor seeking a job. Research shows that the phenomenon follows from greater concern with clientelist politics than with good policies.

Strike two: population loss. Currently, Puerto Rico is losing 5% of its residents about every four years to outmigration. Within half a decade it will also begin to lose them through demographics,

and to give a measure of things to come, within just one decade the population under the age of 5 has shrunk by over a fourth.

Re-distribution—rather than growth—is in local policymakers' DNA

Would you say this country is going to start growing soon and pay its debtors in full? Krueger and colleagues hope so, and offer a host of policy proposals, but overestimate the government's technical and political capital. They also forget that re-distribution—rather than growth—is in local policymakers' DNA. Structural reforms will never happen without technical aid, conditioned financing and a lot of tough love from the U.S. Money is, of course, a problem, but if push comes to shove, aid could be made revenue neutral. That is, [the U.S. is already providing the island a back door bailout to the tune of \\$2 billion by turning a blind eye to tax schemes](#) that effectively transfer tax receipts from the U.S. to the Puerto Rican treasury.

Rather than channeling it through the government, it would be immensely more useful if that money was allocated to projects that could get our island on a path to growth. Foremost among these would be programs to promote work through a proper EITC program and for financing improvements in education and entrepreneurship through a competitive proposal process focused on flexibility, accountability and the management skills of the private, academic and non-profit sectors. That approach is based on participative development, diffusion of best practices, and fosters the social learning process required to address the island's daunting problems.

A chance at social mobility

If controversial initiatives such as school vouchers prove to be too much, alternatively the middle class has to be attracted back to the public school system by whatever means necessary. Magnets and charters are just two alternatives. High-quality preschool is an expensive but a highly productive means for improving cognitive and non-cognitive skills associated with a wide range of positive later life outcomes. For Puerto Rico's truly disadvantaged it may well be the best chance for social mobility.

I know that many are counting on scenarios of governments that can get the island out of its predicament through technical prowess and leadership, but most would be overwhelmed by the scale of the challenges ahead. This agenda will not get Puerto Rico growing soon, only substantial financial aid will do, but it can provide hope that in the end the island and bondholders may just have a chance after all.

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